

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-07 ISO-00 CIAE-00 PM-04 H-02 INR-07 L-03

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AID-05 COME-00 EB-07 FRB-03 XMB-02 OPIC-03 CIEP-01

LAB-04 SIL-01 OMB-01 STR-04 CEA-01 NEA-10 IO-10 /106 W

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FM AMEMBASSY MANILA

TO SECSTATE WASHDC PRIORITY 9798

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USADB

FOR NAC AGENCIES

E O 11652: ADS, DECLAS 2/26/76

TAGS: EAID, EFIN, RP

SUBJ: PROPOSED ADB LOAN FOR DEVELOPMENT BANK OF THE PHILIPPINES
PROJECT

SUMMARY: ADB MANAGEMENT PROPOSES \$25.0 MILLION EQUIVALENT
LOAN FROM ORDINARY CAPITAL RESOURCES TO GOVT OF PHILIPPINES
TO AUGMENT FOREX RESOURCES OF DEVELOPMENT BAK OF PHILIPPINES
(DBP) TO HELP MEET MEDIUM AND LONG TERM CREDIT REQUIREMENTS
OF LARGE AND MEDIUM INDUSTRIES IN PRIVATE SECTOR DURING
1976-77. USADB RECOMMENDS FAVORABLE NAC ACTION.

1. ADB DOC. R118-75 WITH ATTACHMENTS DESCRIBING PROPOSED
LOAN POUCHED ADDRESSEES NOVEMBER 19. BOARD CONSIDERATION
SCHEDULED DECEMBER 19.

2. ADB MANAGEMENT PROPOSING \$25.0 MILLION LOAN FROM ORDINARY
CAPITAL RESOURCES TO GOVT OF PHILIPPINES FOR ON LENDING TO
DBP. PROCEEDS WILL ASSIST DBP IN MEETING FOREIGN CURRENCY
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REQUIREMENTS OF MEDIUM AND LARGE-SIZE PRIVATE MANUFAC-

TURING AND MINING ENTERPRISES. PROPOSED TERMS ARE 15 YEAR AMORTIZATION INCLUDING 3 YEAR GRACE PERIOD, 8-3/4 PERCENT INTEREST. REPUBLIC OF PHILIPPINES TO BE BORROWER AND DBP THE EXECUTING AGENCY. GOVT WILL RELEND TO DBP ON SAME TERMS AND CONDITIONS. DBP WILL CHARGE 12 PERCENT, WHICH IS MAXIMUM LEGAL RATE FOR SECURED LOANS IN PHILIPPINES.

3. INDUSTRIAL SECTOR PRESENTLY IS THIRD LARGEST SECTOR (AFTER AGRICULTURE AND SERVICES) OF PHILIPPINE ECONOMY, CONTRIBUTING ABOUT 26 PERCENT TO NET NATIONAL PRODUCT IN 1974. ALTHOUGH ACCOUNTING FOR OVER ONE-THIRD OF ANNUAL GROSS DOMESTIC CAPITAL FORMATION, INDUSTRY EMPLOYEES ONLY ABOUT 10 PERCENT OF LABOR FORCE. OVER HALF OF COUNTRY'S INDUSTRIES ARE LOCATED IN GREATER MANILA AREA. MANUFACTURING ACCOUNTS FOR OVER TWO-THIRDS OF TOTAL INDUSTRIAL OUTPUT. IT CONSISTS OF RELATIVELY LARGE-SCALE UNITS, PRIMARILY IN FOOD AND BEVERAGES, CHEMICALS AND PETROCHEMICALS, AND TEXTILES. DUE TO ENERGY CRISIS AND RECENT DEVELOPMENTS IN INTERNATIONAL ECONOMY, INDUSTRIAL GROWTH IN FISCAL YEAR ENDED JUNE 30, 1975 SLOWED DOWN TO 4.5 PERCENT COMPARED WITH ANNUAL RATE OF 8.5 PERCENT AVERAGE ANNUAL RATE IN CALENDAR YEARS 1970-74.

4. BULK OF INSTITUTIONAL TERM FINANCE TO DATE HAS BEEN PROVIDED BY DBP. IN PAST TWO YEARS IT ACCOUNTED FOR ABOUT 13 PERCENT OF TOTAL FIXED CAPITAL FORMATION AND 26 PERCENT OF TOTAL IN MANUFACTURING AND MINING. WITH LARGE PART OF ITS RESOURCES COMMITTED TO FINANCING MEDIUM AND LARGE-SCALE INDUSTRIES, IT IS MOST IMPORTANT GROWTH VEHICLE FOR ECONOMIC DEVELOPMENT OF PHILIPPINES.

5. DBP IS SUCCESSOR TO REHABILITATION FINANCE CORPORATION, WHICH WAS ESTABLISHED IN OCTOBER 1946 TO PROVIDE CREDIT FACILITIES FOR REHAB. AND DEVELOPMENT OF AGRICULTURE, COMMERCE AND INDUSTRY, AND RECONSTRUCTION OF PROPERTY DAMAGED DURING WAR. UPON ESTABLISHMENT IN JUNE 1958, DBP'S SCOPE WAS ENLARGED TO INCLUDE PROVISION OF FUNDS FOR ESTABLISHMENT OF PROVINCIAL AND CITY DEVELOPMENT BANKS. AUTHORIZED CAPITAL OF PESO 3 BILLION (ABOUT LIMITED OFFICIAL USE

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\$444 MILLION) IS FULLY SUBSCRIBED BY GOVT, OF WHICH ABOUT PESO 1.75 BILLION WAS PAID IN AS OF MARCH 31, 1975. GOVT PLANS ANNUAL CONTRIBUTIONS TO COMPLETE PAID IN SUBSCRIPTION BY FY 1981.

6. PRIOR TO 1965, DBP EXTENDED ONLY PESO LOANS, WITH BORROWERS USING PESO LOANS TO BUY FOREIGN CURRENCY FROM CENTRAL BANK FOR EQUIPMENT IMPORTS. SUBSEQUENTLY, DBP

RESORTED INCREASINGLY TO GUARANTEEING FOREIGN SUPPLIERS' CREDITS. BEFORE 1973, FOREIGN COMMERCIAL BANKS, USAID, U.S. EXIMBANK AND KFW (WEST GERMANY) WERE MAIN SOURCES FOR DBP'S FOREIGN CURRENCY BORROWINGS. IN FY 1975, FIRST WORLD BANK CREDIT LINE OF \$48.0 MILLION BECAME AVAILABLE FOR INDUSTRIAL SECTOR FINANCEING. SECOND IBRD LOAND OF \$75.0 MILLION IS PRESENTLY UNDER CONSIDERATION.

7. ASSISTANCE TO INDUSTRIAL SECTOR ACCOUNTED FOR 65 PERCENT OF DBP'S TOTAL ASSISTANCE IN FY 1972 AND FY 1973, 90 PERCENT IN FY 1974 AND DOWN TO 40 PERCENT IN FIRST NINE MONTHS OF FY 1975 DUE TO APPROVAL OF SEVEN HOTEL PROJECTS INCONNECTION WITH FORTHCOMING IMF/IBRD MEETING TO BE HELD IN MANILA AND TO COPE WITH INCREASING TOURIST TRAFFIC. AS RESULT, REAL ESTATE FINANCING ROSE SHARPLY TO 36 PERCENT OF NINE-MONTH FY 1975 TOTAL FROM 12 PERCENT IN FY 1974. GEOGRAPHICALLY, BULK OF ASSISTANCE HAS GONE TO LUZON, ALTHOUGH SHARE OF MINDANAO HAS INCREASED SUBSTANTIALLY IN LAST THREE YEARS.

8. AS OF JUNE 30, 1975 ABOUT 15 PERCENT OF DBP'S LOANS AND GUARANTEES WERE IN ARREARS MAINLY DUE TO (A) 1970 PESO DEVALUATION WHICH INCREASED SUB-BORROWERS' FOREIGN LOAN BY 60 PERCENT; (B) DEFICIENT PROJECT APPRAISAL BY DBP PRIOR TO 1970; (C) VERY SHORT MATURITIES OF SUPPLIERS' CREDIT GUARANTEED BY DBP; AND (D) INFLATION, FUEL PRICE INCREASES AND RECESSION ABROAD. DBP HAS AGREED TO COMPLETE REVIEW OF PORT FOLIO BY MARCH 31, 1976 AND RESTRUCTURING, WHERE APPROPRIATE, OF ACCOUNTS. IT HAS DRAWN UP PROGRAM WHICH INCLUDES INCREASE IN STAFF,

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ACTION TRSE-00

INFO OCT-01 EA-07 ISO-00 CIAE-00 PM-04 H-02 INR-07 L-03

NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

AID-05 COME-00 EB-07 FRB-03 XMB-02 OPIC-03 CIEP-01

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P 260800Z NOV 75
FM AMEMBASSY MANILA
TO SECSTATE WASHDC PRIORITY 9799

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IMPROVEMENT OF APPRAISALS AND CLOSER FOLLOW-UP PROCEDURES. PART OF ARREARS PROBLEM IS RELATED TO LOW PENALTY RATES, AND DBP WILL INCREASE PENALTY CHARGES FROM 4 PERCENT PER ANNUM TO 3 PERCENT PER MONTH FOR ARREARAGES OVER 90 DAYS. (SIDE LETTER NO. 2.)

9. DBP'S ARREARAGE SITUATION COUPLED WITH FACT THAT PROPORTION OF DBP'S SHORT AND MEDIUM TERM RESOURCES TO TOTAL RESOURCES HAS BEEN EXCESSIVE HAS ADVERSELY AFFECTED LIQUIDITY POSITION. EIGHTY PERCENT OF AMOUNTS INVOLVED IN HOTEL FINANCING PROGRAM (PARA 7 ABOVE) WHICH IS FOR 12-YEAR PERIOD, IS TO BE FINANCED BY ONE-YEAR SECURITIES REPURCHASED AGREEMENT WITH CENTRAL BANK WITH ROLL-OVER ARRANGEMENT FOR 5-YEAR PERIOD. TO ALLEVIATE DBP'S HIGHLY UNSATISFACTORY LIQUIDITY PROBLEM, GHE GOVT HAS AGREED TO (A) TAKE NECESSARY STEPS TO REFINANCE NOT LATER THAN JUNE 30, 1980 SHORT-TERM FUNDS BORROWED BY DBP FROM CENTRAL BANK FOR FINANCING HOTEL PROGRAMS; (B) CONVERT PESOS 400 MILLION OF SHORT-TERM TREASURY DEPOSITS WITH DBP INTO LOANS OF NOT LESS THAN FIVE YEARS MATURITY; AND (C) TAKE STEPS TO ENSURE THAT DBP'S LONG-TERM LENDING IS FINANCED EITHER BY EQUITY OR BY MEDIUM AND LONG-TERM LOANS. (SIDE LETTER 2, PARA. 3.) FOR ITS PART, DBP'S MANAGEMENT
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IS MAKING EFFORTS TO RAISE LONG-TERM RESOURCES BY ISSUE OF LONG-TERM BONDS UNDER GOVT GUARANTEE. IT IS CURRENTLY OFFERING FOR SALE PESO 500 MILLION OF QUOTE COUNTRYSIDE BILLS UNQUOTE UNDER SUCH GUARANTEE.

10. AT END FY 1975, DBP'S CURRENT RATION WAS 1.2, INTEREST COVERATE RATION 1.6 AND TOTAL DEBT/EQUITY RATION (INCLUDING ALSO SHORT-TERM DEBT AND GUARANTEES WHICH IN EFFECT SUBSTITUTE FOR LONG-TERM DEBT) 4.2:1. CURRENT RATION IS EXPECTED TO REMAIN BETWEEN 1.3 AND 1.6 AND DEBT SERVICE RATION BETWEEN 1.2 AND 2.1 DURING FY 1976-1979. DEBT/EQUITY RATION WILL REACH 4.9:1 IN FY 1979.

11. ALTHOUGH DBP PASSES ON FOREX RISK ON GUARANTEE OPERATIONS AND ON FIREIGN LOANS TO SUB-BORROWERS, EXCHANGE RISK ON ABOUT \$110 MILLION OF VARIOUS COMMERCIAL FOREIGN BORROWINGS, WHICH WAS RELENT IN DOMESTIC CURRENCY, REMAINS WITH DBP. IN VIEW SUBSTANTIAL EXPOSURE TO FOREX

RISK, DBP HAS AGREED TO CREATE A SPECIAL FOREX RISK RESERVE BY APPROPRIATING 20 PERCENT OF ANNUAL NET INCOME UNTIL RESERVE REACHES MINIMUM LEVEL OF 15 PERCENT OF TOTAL FOREIGN LIABILITIES ON WHICH DBP BEARS EXCHANGE RISK. DBP AND GOVT HAVE ALSO AGREED TO MAKE ADEQUATE ARRANGEMENTS TO PROTECT DBP AGAINST LOSSES RESULTING FROM EXCHANGE RATE CHANGES. BEFORE EFFECTIVENESS OF PROPOSED BANK LOAN, DBP WILL ADOPT APPROPRIATE RESERVE POLICY, ACCEPTABLE TO BANK, WHICH WILL INCLUDE ADEQUATE PROVISION FOR DOUBTFUL LOANS AND EQUITY INVESTMENTS, A FOREX RISK RESERVE, AND CONTINGENCY RESERVE.

12. GOVT, FOR ITS PART, HAS ASSURED PROVISION OF NECESSARY LOCAL CURRENCY FINANCING FOR DBP. IT WILL ALSO TAKE NECESSARY STEPS TO ENSURE THAT DBP IS PROTECTED AGAINST ANY EVENTUAL DEFAULT OR LOSSES ON LOANS MADE BY DBP AT GOVT REQUEST TO MEET SPECIFIC PRIORITIES ESTABLISHED BY GOVT. (SIDE LETTER NO. 2, PARA. 4.)

13. ALLOCATION OF PROPOSED LOAN EXPECTED TO BE 20 PERCENT TEXTILES AND GARMENT INDUSTRIES, 20 PERCENT MINING, 10 PERCENT WOOD PROCESSING, 10 PERCENT FOOD PROCESSING, 10 PERCENT METAL FABRICATION, 10 PERCENT PROGRESSIVE CAR LIMITED OFFICIAL USE

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MANUFACTURING AND 20 PERCENT OTHER MANUFACTURING. MAXIMUM SIZE OF INDIVIDUAL SUBLOANS WILL BE \$3.5 MILLION. FREE LIMIT ON SUBLOAN APPROVALS BY BORROWER WITHOUT PRIOR BANK APPROVED WILL BE \$750,000, WITH AN AGGREGATE FREE LIMIT OF \$10 MILLION. DBP WILL SATISFY THAT PROCUREMENT PROCEDURES ADOPTED BY SUB-BORROWERS UNDER PROPOSED LOAN ARE APPROPRIATE IN THE CIRCUMSTANCES AND WILL BE PURCHASED AT REASONABLE PRICES TAKING INTO ACCOUNT SUCH RELEVANT FACTORS AS DELIVERY TIME, EFFICIENCY AND RELIABILITY OF GOODS AND AVAILABILITY OF SPARES AND MAINTENANCE FACILITIES.

14. THERE IS CONSIDERABLE ROOM FOR IMPROVEMENT IN DBP'S POLICIES AND PROCEDURES RELATING TO INDUSTRIAL FINANCING. PROGRAM IS NOW BEING IMPLEMENTED TO STRENGTHEN STAFF AND IMPROVE APPRAISAL AND FOLLOW-UP OF PROJECTS. USADB BELIEVES THAT COMBINED INFLUENCE OF ADB AND WORLD BANK CAN HELP TO MINIMIZE WEAKNESSES IN DBP PERFORMANCE. THEREFORE, ON BASIS VARIOUS ASSURANCES OBTAINED BY BANK, USADB SUPPORTS PROPOSAL AND RECOMMENDS FAVORABLE NAC ACTION.

15. U.S. MISSION MANILA PREPARING COMMENTS SEPTEL FOR NAC AGENCIES PURSUANT TO STATE 119795 DATED 3 JULY 1972. SULLIVAN

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